

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 97-0110 S/U
SALES AND USE TAX
For The Period: 1993 Through 1995**

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ISSUES

I. Sales and Use Tax: Manufacturing Exemption

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8; Indiana Dept. of State Revenue v. Cave Stone, 457 N.E.2d 520 (Ind. 1983); Harlan Sprague Dawley v. Indiana Dept. of State Revenue, 605 N.E.2d 1222 (Ind. Tax 1992); Mid-America Energy Resources, Inc. v. Indiana Dept. of State Revenue, No. 49T10-9504-TA-00038, (Ind. Tax May 22, 1997)

The taxpayer protests the imposition of sales/use tax on equipment.

II. Tax Administration: Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

The taxpayer protests the imposition of the 10% negligence penalty.

STATEMENT OF FACTS

The taxpayer is a supplier of steel beams, which are used as structural supports in commercial buildings. The majority of the steel beams are sold in the same form as originally purchased, with the remaining sales in accordance with customer specifications.

I. Sales and Use Tax: Manufacturing Exemption

DISCUSSION

In general, all purchases of tangible personal property are taxable. However, IC 6-2.5-5-3 and 45 IAC 2.2-5-8 provide that manufacturing machinery, tools, and equipment are exempt for sales/use tax if the person acquiring the property acquires it for the direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining or finishing of other tangible personal property. The taxpayer, *contra* the auditor, argues that when it cuts steel beams to customer specifications, it is a manufacturer and that the above exemptions apply to it.

In order for the exemption to be applicable the taxpayer must show that they are engaged in “production.” (See, Mechanic’s Laundry & Supply, Inc. v. Dept. Of State Revenue, 650 N.E.2d 1228 (1995). Production can occur through manufacturing, processing, or other activities listed in the exemption. Dept. of State Revenue v. Cave Stone, 457 N.E.2d 520 (1983).

Various types of activities have been found by Indiana courts to be “production” under IC 6-2.5-5-3. A triad of cases, Indiana Dept. of State Revenue v. Cave Stone, Harlan Sprague Dawley v. Indiana Dept. of State Revenue, and Mid-America Energy Resources, Inc. v. Indiana Dept. of State Revenue, must be analyzed to determine whether or not the taxpayer meets the threshold question with regard to production

In Cave Stone the Indiana Supreme Court acknowledged the “essential and integral” test as a means for determining whether or not the double direct test is met. The Court recognized that the whole production process must be focused on. In Harlan Sprague Dawley the Tax Court ruled that “production” occurred when rats were bred in a sterile environment to create offspring with particularized, desired characteristics. In rejecting the Department’s position that there was no processing because no new product distinct from its input emerged, the Tax Court ruled that the taxpayer did create something new, namely, viral free rats, which were valuable goods for research laboratories. The Tax Court also pointed out that “production is viewed expansively as all activity directed to increasing the number of scarce economic goods.” And finally, in Mid-America Energy, the Tax Court similarly found that the taxpayer’s cooling of water constituted production of other tangible personal property. The cooling process created a significant change in the properties at the molecular level.

The auditor contends steel is steel and that no processing is occurring to the steel beam when it is cut to customer specifications. Instead, the auditor argues, the taxpayer is providing a service. In contrast, the taxpayer notes that the Department considers saws used to split lumber to specific lengths to be exempt under the manufacturing exemption, and that meat slicers acting on carcasses (or “primals”) have been held by the Department to be exempt. However, the taxpayer is not acting upon raw materials as is the case in the two examples above. The taxpayer purchases steel beams, warehouses the beams, and then sells the beams. Approximately 15 to 23 percent of the time the taxpayer cuts beams to customer specification. The steel beams retain

their character and composition after the cutting, and are identifiable as beams. In the triad of cases cited above (Cave Stone, Harlan Sprague Dawley, and Mid-America Energy) raw, idle resources were being acted upon to increase scarce economic goods: stone, rats, and water. Here, as is evidenced by the majority of the taxpayer's sales, a finished product is being acted upon. The cutting of the beams does not increase a scarce economic good.

FINDING

The taxpayer's protest is denied.

II. Tax Administration: Penalty

DISCUSSION

The taxpayer next protests the imposition of a 10% negligence penalty. Under 45 IAC 15-11-2 negligence is defined as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." The taxpayer contends that it has filed its tax returns in a timely manner and has compared its operations to similar business operations.

The taxpayer argues that it was non-negligent since it thought it was a manufacturer. There were also other non-controversial items found by the auditor, including office supplies and the rental of tangible personal property, which under the rubric of manufacture or service were still taxable.

FINDING

The taxpayer's protest is denied.